

DESIGN AND DELIVERY OF THE ENERGY CODE REFORM ENERGY FUTURE SYSTEM OPERATOR

Consultation response(s) from OGUK

Summary

OGUK is the leading representative organisation for the UK offshore oil and gas industry. Our membership includes over 400 organisations with an interest in the UK's upstream oil and gas, and other energy sectors including offshore wind. As the champions of industry, we work on behalf of the sector and our members to inform understanding with facts and evidence, engage on a range of key issues and support the broader value of this industry in a changing energy landscape. From exploration through to decommissioning and located across the length and breadth of the UK, our members are critical to safely providing security of energy supply, while supporting around 270,000 jobs and contributing billions of pounds to the economy each year.

The oil and gas sector is fully aligned with supporting the UK achieve net-zero by 2050, having developed its own Roadmap 2035¹ in 2019 and emission reduction targets for the sector in 2020². The sector recently agreed the North Sea Transition Deal (NSTD)³ with government setting out the role of the sector in reducing emissions from oil and gas production and in delivering the objectives on CCUS and Hydrogen as set out in the Energy White Paper and the Prime Minister's Ten Point Plan. Much of the content of this agreement was based on the Energy Integration Project⁴ produced by Ofgem, with the Oil and Gas Authority and other regulators. This ground-breaking deal is a commitment from both industry and government that will ensure the UK achieves their net-zero future. It also underlines the increasing inter-relations between different elements of the energy sector, particularly offshore. Many OGUK members are now heavily involved in offshore renewable projects, including fixed and floating wind, alongside their tradition businesses.

It is clear that these changes will require evolution across a range of legislative requirements, regulatory decisions, the licences of network businesses and the industry codes. Some of these issues are already being addressed, for example through the RIIO2 process or in the development of new business models for CCUS and Hydrogen.

Although some aspects of the code governance process could usefully be adapted, industry remains somewhat unconvinced that such a full-scale restructuring set out in the consultation document is needed. For example, strategic direction can already be provided by government and through Ofgem to the Code process via the Strategic Policy Statement and Significant Code Reviews. Similarly abolishing the existing Code Panels, which have been effective in dealing with a number of issues to date, seems an over-reaction. It makes more sense for much of the technical detailed work to continue

¹ <https://roadmap2035.co.uk/>

² <https://oilandgasuk.co.uk/product/production-emissions-targets-report/>

³ <https://oilandgasuk.co.uk/nstd/>

⁴ [Oil and Gas Authority: UKCS Energy Integration - Final Report - 2020 - Publications - News & publications \(ogauthority.co.uk\)](https://publications.ogauthority.co.uk/)

to be developed through an industry-led process although additional strategic direction and prioritisation could be envisaged.

Regarding the overall approach, and the role of the Future System Operator, OGUK would not support Option 2 with a single IMRB approach and centrally controlled processes. Although the ESO does successfully coordinate some aspects of development of the electricity networks there is not a strong case to extend this to other areas. In addition, the creation of multiple public bodies with an “strategic” oversight\influence over the energy sector could lead to confusion and potential friction between them. Furthermore, the timeframe for the creation of the new organisation would be better used to process change using the existing framework and structures that are probably sufficient for most things.

More widely, both consultations appear to discuss form over substance which seems to be the wrong priority. Energy companies are largely committed to the net zero objective and the emphasis should be on making rapid decisions that enable this process rather than time consuming redesign of governance structures. Making full use of the existing range of decision-making processes is arguably a better approach.

OGUK
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CODE GOVERNANCE CONSULTATION QUESTIONS

1.To what extent do you agree with our proposals on the licensing of a code manager for in-scope engineering standards, and why?

No comments

2.What are your initial views on how central system delivery bodies should be regulated (including their relationship or integration with code managers and the extent to which licensing may be appropriate), bearing in mind this may be the subject of future consultation?

System delivery bodies such as Xoserve are essential to the efficient functioning of the whole process and the market. The current approach to treating them as a service provider works well and there is not a strong case for change.

3.To what extent do you agree with the detailed roles and responsibilities of the strategic function, as set out above, and why?

Option 1 could already be mostly developed by using the existing framework in the Energy Act 2013 with Ofgem being given a more detailed set of responsibilities via a renewed Strategic Policy Statement. This mirrors the process that has already been carried out through the review of the OGA Strategy which concluded in February 2021. Ofgem could then have a stronger locus to give guidance to the existing code process. To the extent a more formal designation is given, Ofgem may need some internal reorganisation to separate the implementation of the new strategic function from its role in approving modification changes.

4. To what extent do you agree with the roles and responsibilities of the code manager function as set out above, and why?

Moving to an approach where most code changes are initiated by a licensed code manager would be a major change from the current system for the UNC whereby the Joint Office coordinates an industry process between code signatories. Although there is arguably a need for more strategic direction and coordination, OGUK members retain the view that much of what needs to be done can be achieved through the existing industry-led processes.

Producing a forward delivery plan, triage process and a set of priorities, agreed between Ofgem and the Joint Office could also fill such a role. However, a clear process will be required to determine how the code manager would make these decisions since the financial/customer/environmental impact and lead time may only become clear once the proposal has been developed.

Efficient processes for code changes with an agreed timeline (similar, for example, to the framework used by the CMA) would be an improvement to the current system. Many modification processes have taken too long and Ofgem's approval process has not been timely. There is also a need to coordinate changes around commercial processes especially when close to the periods when contracts are being agreed.

5. To what extent do you agree with the proposed roles and responsibilities of stakeholders as set out above, including the role of the stakeholder advisory forum, and why?

OGUK members disagree with the removal of the Industry Panel. The process is well established and has dealt successfully with the implementation and evolution of the codes over many years. Although there may be grounds for a greater level of strategic direction and prioritisation, a very high proportion of modification processes are not in this category and should continue to be dealt via an industry framework. As noted in the consultation, the CMA considered that the self-governance scheme improved the overall efficiency of the code regime.

6. In relation to option 1, where Ofgem would be the strategic body, to what extent do you agree with our proposals on how decisions by the code manager would be overseen by the strategic body with, as a minimum, existing appeal routes retained and moved to the strategic body?

7. In relation to option 2, where the FSO would take on the role of the IRMB, to what extent do you agree with our proposals on how relevant decisions by the code manager function would be appealable to Ofgem, with a potential prior review route via an internal body?

8. Do you have any views on the two proposed options for appealing decisions made by Ofgem on material code changes in option 1 (with Ofgem as the strategic body) and option 2 (with the FSO as the IRMB)?

9. Do you have any thoughts on other potential appeal routes?

Composite answer to questions 6-9 on appeals:

Establishing Ofgem with a formal role as strategic body would strengthen its oversight of the code process. If Ofgem were to have both a strategic and an appeal function, there may need to be internal separation within Ofgem to fulfil these separate roles. Industry would not welcome a dilution of the current CMA appeal route and is not in favour of the option that only allows for a Judicial Review process. The CMA is, in any case, responsible for the implementation of competition law and there is a high level of synergy between these responsibilities and the terms and conditions of access to infrastructure.

OGUK does not support the Option 2 model. A key reason for this is the overlaps and potential confusion caused by having two bodies with a strategic role alongside the role of government. The lines of accountability would become unclear. Whereas under option 1 there would at least be a clear hierarchy from government, via Ofgem into the code process and the role of the system operator.

10. To what extent do you agree with the proposed operating model and accountability structure for Ofgem as the strategic body, and why?

There remains a need to have some form of separation between Ofgem's general duties and any newly acquired strategic role. This need not be a separate Board but there could be some kind of delegated structure (similar to Ofgem's existing enforcement Panel). As well as engaging with consumer groups and stakeholders, it is also essential the Ofgem in its role as strategic body conducts its own research into the views of consumers, investors, and other stakeholders.

11.To what extent do you agree with the monitoring and evaluation approach for Ofgem's performance as the strategic body, and why?

The approach set out in the consultation whereby Ofgem is accountable to the Secretary of State is a sensible approach, including an annual report how it has fulfilled the requirements of the SPS.

12.To what extent do you agree with the ways we propose that the strategic body select code managers, and why?

As discussed above, the shift from a contractual arrangement between network operators and the Joint Office towards a licenced code manager function is a significant change. In selecting a code manager, OGUK would maintain that code signatories need some involvement, and it is essential that the code manager is separate and independent from other licenced functions including any future system operator role.

There is a significant risk of conflicts of interest in appointing the FSO or a subsidiary which it would be difficult to deal with in practice. In addition, the idea that there are synergies between the FSO role, and the code manager role is unconvincing. The key competences of the code manager should be in programme implementation and governance whereas the FSO role is envisaged primarily as a technical function in the parallel consultation. The fact that the FSO would not appear to be set up until 2026 also would appear to rule this out as a workable option.

13.To what extent do you agree with our proposed approach to code manager funding, and why?

14.To what extent do you agree with our proposal that the strategic body should be accountable for code manager budgets, and why?

OGUK does not have strong views on this topic.

15.To what extent do you support the proposed operating model and accountability structure for option 2, where the FSO takes on the role of the IRMB, and why?

OGUK does not support the concept of the IRMB or that the future system operator takes on such a role. Firstly, the FSO will take too long to set up. There will inevitably be points of friction within the FSO, and between the FSO, the industry regulator and potentially government. The lines of accountability and the duties and functions of the FSO are unclear. It would give the FSO an unbalanced role in the future energy system without sufficient checks and balances.

16.Overall, which of the two options do you think would be best placed to reform code governance, and why?

Option 1 is preferable although, as discussed, OGUK believes that many of the objectives could be achieved through the existing system in terms of greater use of the Strategic Policy Statement framework and the potential use of Significant Code Review processes.

17.To what extent do you agree with our estimated costs for the new code manager function set out in the impact assessment, and why?

18.To what extent do you agree that the case studies included in the impact assessment are indicative of the major barriers facing code changes under the current system, and why? Can you provide further examples of when current code governance has resulted in either optimal or sub-optimal outcomes?

19.To what extent do you agree with the scale and type of benefits to industry estimated in the impact assessment? Are there further cost savings to industry that should be included?

Composite answer to questions 17-19 on the impact assessment:

The impact assessment mainly concentrates on the potential additional costs of implementing the two options with the potential benefits being non quantified. Clearly the objective for code governance should be better outcomes for customers as well as the promotion of new business models, innovation, and investment. However as shown in today's market conditions, it is sometimes difficult to predict outcomes from individual policy interventions.

In terms of the value added coming from reforms, the use of the gas charging process as a case study is not particularly helpful. It was a commonly held view that this process could have been conducted as a Significant Code Review so could have been implemented more efficiently using the existing framework. The process would have been much quicker and smoother if Ofgem actually played an active role during the development stage i.e. providing meaningful input and views when asked to do so.

20.Are there any other wider industry developments we should consider in relation to the implementation timeline? How do you think these could impact on code reform?

No comments.

21.Are there any implementation issues, risks, or transition considerations we should take into account? How could these impact code reform?

The main risk is that the proposed changes to the code framework and the status of the system operator will take up time and attention that could be better used for making improvements to the codes themselves.

As well as considering these changes to the governance system. Government and regulators should also be giving attention to regulatory changes today that can be implemented rapidly to progress the pathway to net zero. For example, OGUK has been participating in the Future of Gas Steering Group that is currently producing recommendation for potential code changes. The exemption framework proposed in Modification 0760 may also allow for implementation of pilot projects in particular regions.

SYSTEM OPERATOR CONSULTATION QUESTIONS

1. Do you agree that net zero will create the need for new technical roles in the electricity and gas systems, and require a new approach to energy system governance?

In general, is it clear that the scale of the future changes in the energy system to achieve net zero do require new approaches to be developed. At the same time, government and regulators should also avoid giving up the many benefits of decentralised and competitive energy provision which have much to offer in delivering investment and efficient outcomes. For example, well-functioning energy companies are able to optimise efficiently between the different electricity, gas and carbon markets and will be able to bring these attributes to new sectors such as hydrogen. Misplaced interventions have already unduly disrupted these processes, and this has eventually led to the current negative impact on consumers.

2. Do you agree that the establishment of a Future System Operator is needed to fulfil the kinds of technical roles needed to drive net zero?

A greater degree of coordination is probably needed, particularly between the different levels of system operation and, to a lesser extent, between electricity and gas. A degree of system planning is required however it must be acknowledged that technologies, commodity prices and costs will all change over time. The idea that any organisation can calculate a “lowest cost” pathway to net zero is illusory and thus the system operator framework needs to remain flexible as well as considering the required reliability and resilience of energy supply as well as a one-dimensional view of costs.

3. Do you agree that a Future System Operator should have roles in both the electricity and gas systems?

The gas and electricity networks generally make a distinct and separate contribution to the overall energy system and there is currently minimal overlap in terms of services provided to consumers. At present consumers generally use electricity for one set of applications and gas for a largely different set of things. This may change to some degree in future. However, the case for merging network planning for the two different systems is not, in fact, particularly strong. For example, even if a proportion of domestic heat users choose to change to electricity, this would not affect the need for continuing to provide a resilient gas network for the remaining consumers.

In addition, by merging these functions there is some risk of “goal fixation” around a particular outcome that may not be reflected by consumers desired outcomes. This is more likely than not to favour electricity-oriented solutions if the FSO role on gas is considered subordinate. To the extent that gas and electricity become competing products for certain uses, it could be preferable to retain a separate system operation function that can prepare for a range of different outcomes rather than seeking to second guess the outcome of this competitive process.

4. Do you agree that a Future System Operator should be entirely separate from National Grid plc?

The split between the owner and operator functions for electricity in terms of legal entity is now relatively well established and accepted. OGUK do not have a view on whether it makes sense to separate entirely in terms of ownership.

5. What issues are there with existing institutional arrangements in the UK energy system in relation to system-wide decision-making and planning?

Many of the most important emerging issues are not, in fact, around the arrangements around network operators. A more important issue is that the current framework for price controls is not particularly well suited to the challenge of delivering a huge expansion in energy sector investment. The CCC estimate that this needs to increase to some £50bn per annum to achieve net zero. It is doubtful whether the structure in place for RIIO2 involving repeated reopener processes is fit for purpose in this context. Creating a further body such as the FSO with a strategic oversight alongside Ofgem, with the TOs in the middle, risks creating a recipe for slow progress in this respect.

In addition, the CCC and National Infrastructure Commission have both recommended that regulators' primary statutory duties should be adjusted to reflect the net zero objective. This would arguably have more impact on the rate of progress if this allowed for investment in networks and other aspects of the energy system to be realised more quickly.

6. What examples/case studies are you aware of where net zero delivery in one part of the energy system did not adequately account for cross-system impacts or costs?

The development of offshore electricity networks is a clear area where cross system impacts have not been taken into account. The OFTO system has delivered a piecemeal set of radial connections and failed to consider longer term objectives with respect to more ambitious targets for wind, interconnection objectives and the connection of oil and gas assets and other offshore energy elements to the network. Ofgem and the ESO have only recently started to address this question in a holistic way and even with this new attention, progress is almost certainly too slow to deliver on the objectives.

7. Where should government focus in our efforts to improve systems thinking and coordination across the energy system?

As discussed above, the overarching objective should be reoriented around delivering the required levels of investment to deliver net zero. The objective of a resilient and reliable energy system is a close second.

8. Do you agree that the FSO should undertake all the existing roles and functions of NGESO? If not, please explain why.

No comment.

9. Do you agree there is a case for the FSO to undertake the long-term strategic functions outlined in Option 1? Please elaborate and provide any views on the functions we have outlined in Option 1.

Option 1 is preferable to Option 2. However, once the gas system has a separate owner it is almost certain they will also have a view on network planning, forecasting and strategy and will produce their own material in these areas as NGGT does already today. Many other bodies such as the CCC and numerous consultancies are also likely to conduct research on such topics. Government and regulators

should avoid the trap of thinking there is a single version of the truth in view of the considerable uncertainties that exist around the energy transition pathway.

10. Do you agree that there is not currently a case for the FSO to undertake all GSO roles and functions, including real-time gas system operation, as outlined in Option 2? If you do not agree, please explain why.

We agree and do not recommend Option 2.

11. Do you have views on the proposal for an advisory role? What organisations do you consider would benefit from the provision of advice by the FSO? Who should bear the costs of providing that advice?

12. Do you have any views on the other areas where we are considering new and enhanced roles and functions for the FSO (outlined in section 3.2)?

Composite answer on questions 11 and 12 on enhanced FSO functions:

As discussed above, the FSO would not be the only organisation providing advice on these topics and there are many other bodies which will also be looking to perform such analysis. The approach set out in section 3.2 already risks significant overreach and other organisations may be better qualified to provide advice on these subjects. In addition, some of the topics such as CCUS and hydrogen are at an early stage and are not yet of a sufficient national scale to warrant this type of centrally planned concept. Again, the priority should be to deliver successful investment and projects rather than create new functions.

13. What are your views on our proposed characteristics and attributes of a future system operator and how the models presented would deliver against them? Are there other characteristics or attributes that we have not yet considered?

Clearly the aim should be for any FSO to have a high level of competence and the resources it needs to perform the required tasks. For the FSO to fulfil the role envisaged, it needs to go further than simply developing models and scenarios. It also needs to understand different pathways from the current situation towards net zero and how consumers will interact with this process. In terms of consumers, it is not enough merely to be accountable to a narrow set of representative bodies. A higher level of understanding of the needs of consumers is needed and this requires detailed research around what individual consumer types require from the energy system.

14. Are we considering the right organisation models for the FSO? And why?

OGUK does not have strong views on the organisational model or whether it is publicly or privately owned. A high level of independence is needed but this should not rule out energy companies having a stake in the entity provided that no single operator has a controlling interest.

15.Are we considering the right elements for the FSO’s regulatory and accountability frameworks? And why?

Since the FSO is expected to be licenced, this would suggest that the strategic content of its role is subordinate to the SPS and Ofgem’s likely role as the strategic lead for the code governance framework. This would suggest the FSO having more of an advisory function in an updated framework. This might help address some of the potential for duplication and potential conflict between government, regulator and the licensee and make for clearly lines of accountability.

The regulatory structure will be completely new and would need to be subject to separate consultation, in particular the incentives framework. There is not really a template model for how this would work and it requires more thought.

16.Do you have views on the level of shareholding or control involving other ‘energy interests’ and the FSO at which a conflict of interest would become a concern?

See question 14.

17.Are we considering the right implications of our proposals for Elexon and Xoserve?

System delivery bodies such as Elexon and Xoserve are essential to the efficient functioning of the whole process and the market. The approach set out in the document seems appropriate.

18.What is your view on the preferred implementation approach? Please explain why.

The process of implementation appears to be a lengthy one and the concern is that this will reduce attention on the need for the immediate decisions to be taken to facilitate new investment in infrastructure to support offshore networks, electric vehicle charging and to facilitate hydrogen.

19.Based on the areas where we are considering new and enhanced roles and functions for the FSO, which of these should be prioritised for development? Please explain why.

The biggest priority is probably in the electricity sector and in the future requirements for an integrated approach between transmission and distribution networks.

20.What do you believe are the risks to implementation? How can these be mitigated?

See question 18.

21.Do you have any comments on potential implications of implementation for you, your organisation, or other stakeholders?

Please see comments from individual OGUK members.

22.What is your view on the position there are likely to be cost savings across the energy system from an increased “whole system” view, as described in paragraphs 47-52 of the IA? If so, is the potential magnitude of savings illustrated fairly in the IA? If not, why not?

23.What is your view on the conclusion that policy intervention is likely to increase the benefits of onshore electricity network competition, as described in paragraphs 53-59 of the IA? If you agree, is the potential magnitude of savings illustrated fairly in the IA? If not, why not?

24.Do you think that the impact assessment has identified and considered the key costs and benefits of policy intervention? If not, can you provide details on other impacts that have not been considered?

25.Do you think that the distribution of impacts is fairly represented, with impacted groups correctly identified? Outlined in table 5 of the IA.

Composite answer to questions 22-25 on the impact assessment:

The impact assessment is relatively high level. The central figure of an NPV benefit of NPV £2.5bn from an improved “whole system approach” is relatively uncertain although a reasonable attempt has been made to justify the estimate. The estimated saving from better promotion of competition via a separate ESO may be overstated, particularly as the revision of the WACC used in RII02 may give less margin for alternative sources of finance to outcompete. Other potential costs and benefits do not seem to have been considered and the impact assessment is overly focused on cost reduction whereas the main challenge is to accelerate investment. The proposed changes may lead to more or less efficient outcomes on the timing of decision making and this is equally important especially if the cost of carbon emissions were included in the analysis.